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APPLICATION OF

VIRGINIA ELECTRIC AND POWER COMPANY

CASE NO. PUE000343

For approval of generation facilities pursuant to Virginia Code § 56-580 D or, in the alternative, for approval of expenditures pursuant to Virginia Code § 56-234.3 and for a certificate of public convenience and necessity pursuant to Virginia Code § 56-265.2

and

APPLICATION OF

VIRGINIA ELECTRIC AND POWER COMPANY

CASE NO. PUF000021

For authority under Chapters 3, 4, and 5 of Title 56 of the Code of Virginia to participate in lease financing arrangements for construction of generation facilities, and for a declaration of non-jurisdiction

INTERIM REPORT ON PRELIMINARY ISSUES

September 1, 2000

On June 16, 2000, Virginia Electric and Power Company (“Virginia Power” or “the Company”) filed an application with the Commission in which it proposes to reconfigure the generation units at the Possum Point Power Station by taking two existing oil-fired units (Units 1 and 2) out of service, converting two existing coal-fired units (Units 3 and 4) to natural gas, and constructing a new combined cycle generating unit (“the Project”). The Project is proposed to be operational in May 2003 and will increase Company owned generating capacity by approximately 397 megawatts (“MW”).¹ The new generating unit is expected to cost an estimated \$280 to \$300 million. Specifically, the Company requests: (1) approval under § 56-580 D of the Code of Virginia; and (2) a determination that § 56-234.3 does not require approval of the agreements necessary for the proposed synthetic lease financing, or in the alternative, that the Commission grant an exemption from § 56-234.3. The application also seeks a certificate of public convenience and necessity pursuant to Virginia Code § 56-265.2 should the Commission determine that that section is applicable. That application was docketed as Case No. PUE000343. Also on June 16,

¹Units 1 and 2 have a rated capacity of 143 MW, Units 3 and 4 have a rated capacity of 322 MW, and the new unit is proposed to have a capacity of 540 MW.

2000, and related to the Project, the Company filed a Motion for Determination of, or in the Alternative, for Exemption or Waiver from, Bidding Rules.

On July 5, 2000, Virginia Power filed another application related to the Project. In that application the Company seeks (1) authority from the Commission to participate in lease financing arrangements of approximately \$300 million for construction, (2) a declaration that the Commission will not assert jurisdiction over the financing parties to the transaction, and (3) an exemption from, approval under, or determination that approval under § 56-234.3 is not required for the Company to enter into certain agreements in connection with the financing. The July 5 application also seeks (4) approval under (i) the Virginia Utility Securities Act, Chapter 3 of Title 56 of the Code of Virginia because the financing arrangements may be considered to create an evidence of indebtedness; (ii) Chapter 4 of Title 56 of the Virginia Code, because the transaction will involve jurisdictional contracts or arrangements between Virginia Power and a subsidiary of Dominion Energy, Inc., an affiliate; and (iii) Chapter 5 of Title 56 of the Code of Virginia because Virginia Power proposes to transfer real property at Possum Point, by means of a ground lease, on which the new facility will be constructed and will be reacquiring the constructed facility and related real property as a sublease. That application was docketed as Case No. PUF000021.

On July 26, 2000, the Commission issued an Order Inviting Comments and Responses and Prescribing Notice in which it docketed the proceedings, identified preliminary issues presented in these cases, appointed a hearing examiner to make recommendations on those preliminary issues, and required public notice.

The Commission determined that its

consideration of the June 16 Application necessarily turns on resolution of those preliminary issues. Consideration of the merits of the Project makes little sense, for example, if it is determined that the Bidding Rules apply and there is a successful bidder to supply the capacity represented by the Project. Concurrent with resolution of the Bidding Rules' applicability, we will determine which statutory provisions apply to consideration of the Project, should it be found that Virginia Power may proceed with the Application.²

The issues presented by the applications that are addressed in this report include:

- (1) Whether the Bidding Rules³ are applicable to the Project, or in the alternative, if they do apply, whether the Commission should grant Virginia Power an exemption to these Rules.
- (2) Whether the Commission should approve this Project exclusively under § 56-580 D of the Code of Virginia, or under §§ 56-234.3, and/or 56-265.2 as well.

²Order Inviting Comments and Responses and Prescribing Notice at 5.

³20 VAC 5-301-10 et seq.

- (3) If § 56-234.3 of the Code of Virginia applies to this project, whether the Company should be granted an exemption from that provision, or approval under it to make “at risk” financial expenditures in association with the Project.

The Commission provided Virginia Power, Staff and any other interested parties an opportunity to file comments and/or legal memoranda on the issues posed, or any other issues of concern, and to request a hearing on the preliminary issues.

On August 21, 2000, Staff and the Company filed Comments addressing the issues outlined in the Commission’s order. The Virginia Committee for Fair Utility Rates has filed Notices of Protest in both cases, but did not file comments on the preliminary issues. No requests for hearing on the preliminary issues were received.

Staff asserts that the Bidding Rules apply. In order to achieve the objectives of the Virginia Electric Utility Restructuring Act to encourage competition while preserving the benefits Virginia Power asserts its Project will promote, Staff recommends that a bidding process be undertaken on a parallel track with the continued consideration of the Project.⁴ Staff does not object to allowing the Company to begin expenditures on an “at risk” basis, “upon a showing of a critical timing need, and further conditioned upon the bidding process uncovering no superior bid or bids for the supply of the needed capacity.”⁵ Staff also concluded that the application should be considered under the standards articulated in §§ 56.234.3, 56-265.2, and 56-580 D of the Code of Virginia inasmuch as those statutory provisions complement one another and therefore should be applied in tandem.

The Company also filed comments. The Company asserts that the Commission should evaluate the Project pursuant to Virginia Code § 56-580 D and find that Virginia Code §§ 56-234.3 and 56-265.2 are inapplicable, or if § 56-234.3 is deemed applicable, grant the Company approval to proceed with expenditures “at risk.” The Company further seeks a determination that the Bidding Rules are inapplicable to the Project, or in the alternative, grant an exemption from or waiver of those rules.

DISCUSSION

The Bidding Rules

Virginia Power moves the Commission for an order finding the Bidding Rules are not applicable to the Project due to the special environmental aspects and unique structure of the Project. The Company urges the Commission to refrain from rigidly imposing the Bidding Rules on the Project. It asserts that “[o]ther alternatives to the Project cannot be justified from an economic perspective.”⁶

Staff argues that the Bidding Rules apply, and I agree. Attached to its Motion the Company has filed a sworn affidavit of Pamela Faggert, Vice President and Chief Environmental Officer of

⁴Staff Comments at 17.

⁵Id. at 18.

⁶Virginia Power Comments at 8.

Virginia Power. Therein Ms. Faggert details new air emission standards proposed by the Department of Environmental Quality (“DEQ”) and Virginia Power’s compliance plan at Possum Point. Much of the pre-filed testimony also addresses the positive environmental aspects of this Project. The environmental attributes of the Project do appear well planned and extremely positive, and will be fully considered in the Commission’s review of the Project, but do not support a finding that the Bidding Rules are not applicable. The Bidding Rules provide the “minimum requirements for any electric utility bidding program that is used to purchase electric capacity and energy from other power suppliers.”⁷ The Commission has stated that the Rules “established the important quid pro quo that utilities that established bidding programs could refuse offers received outside the bidding program. With limited exceptions, all capacity acquisition was to be conducted through the utility’s bidding program.”⁸ In the order adopting those rules the Commission agreed that “the rules should provide a broad and flexible framework” and that electric utilities should develop bidding programs if “such a process best meets their resource acquisition needs,”⁹ but the Bidding Rules apply to any utility that elects to establish and maintain a bidding program.

The Commission recently considered the applicability of these rules to Virginia Power. In reviewing the Company’s application to construct combustion turbines at its Remington site in Fauquier County,¹⁰ the Commission concluded that Virginia Power “has an active bidding program.”¹¹ The Commission observed that it was:

Unquestioned that Virginia Power established and maintained a bidding program. . . .At no time has Virginia Power advised the Commission or the interested public that it has abandoned its bidding program. . . .If at any time Virginia Power intends to formally abandon its bidding program, then the Company is directed to file with this Commission its notice of election to do so.¹²

Staff observed in its Comments that the Company has not filed such a notice.¹³ The Bidding Rules thus continue to be applicable to any capacity addition Virginia Power might propose.

The Company asserts that if the Bidding Rules are applicable, they provide for an exemption where circumstances dictate the need. The Company maintains that circumstances warrant an exemption in this case. It argues that the Project will bring improved air quality in a serious ozone non-attainment area in a cost-effective manner, improve fuel efficiency, increase available capacity and reliability, and optimize the use of an existing power station site; and thereby, has major environmental and economic implications for the public. The Company contends that the

⁷20 VAC 5-301-10.

⁸Id.

⁹*Commonwealth of Virginia at the relation of the State Corporation Commission ex parte: In the matter of adopting Commission rules for electric capacity bidding programs* (the “Bidding Rules case”), Case No. PUE900029, 1990 S.C.C. Ann. Rep. 340.

¹⁰*Application of Virginia Electric and Power Company for approval of expenditures for new generation facilities pursuant to Virginia Code § 56-234.3 and for a certificate of public convenience and necessity pursuant to Virginia Code § 56-265.2* (the “Remington case”), Case No. PUE980462, 1999 S.C.C. Ann. Rep. 428.

¹¹Id. at 429.

¹²Id.

¹³Staff Comments at 4.

construction of the new combined cycle unit provides the economic justification to bring natural gas to the Possum Point site, and thus the whole project should be considered as an integrated plan.

In establishing the Bidding Rules, the Commission did provide for limited exemptions. It concluded that:

[P]urchases under tariffs from small power producers and cogenerators, short term, economy and emergency purchases and extensions of existing contracts should be made outside of the bidding process. The rules should not bar a utility from entering into a purchase of extraordinary advantage to it. Under special circumstances a utility and a potential provider may jointly file a petition with the Commission and demonstrate that the opportunity cannot be accommodated in the utility's bidding process and that the terms of the purchase are extraordinarily advantageous.¹⁴

The Bidding Rules therefore provide that “[a] utility may file for exemptions from any or all of these bidding program requirements. In making its decision regarding exemptions, the Commission will consider the size of the utility’s operations in Virginia and the requirements of other regulatory bodies having jurisdiction over the utility.”¹⁵

Virginia Power has applied for and received waivers of the Bidding Rules twice, once in 1996 and again in 1997. One case involved an application by Virginia Power to construct a generation facility to be located at and used by one specific customer, the Chesapeake Paper Products Company, at its mill.¹⁶ The proposed generation did not, as this application does, represent an addition to system capacity. That project met “the specific needs of a customer, and could not be accommodated within the competitive bid process.”¹⁷ The second case involved a settlement of disputed issues arising from a 25-year power purchase and operating agreement between Virginia Power and Richmond Power Enterprise, L.P. The Commission, citing Staff testimony, found that the capacity savings resulting from the agreement more than offset the cost of the plant, and that the proposed transaction, compared to the existing contract, benefited the utility and its ratepayers.¹⁸ More recently, in *Remington*, the Commission denied a request for waiver, authorized the Company to do site work at its own risk and expense, but required the Company to issue a request for generation proposals.¹⁹ Indeed careful consideration of market alternatives to Company built capacity is particularly important as Virginia prepares for competition. Also in *Remington*, the Commission opined that it would favor awarding power supply contracts for

¹⁴The *Bidding Rules* case, supra, at 340-341.

¹⁵20 VAC 5-301-10.

¹⁶*Application of Virginia Electric and Power Company, Virginia Power SPC-I, Inc., Virginia Power SPC-II, Inc., and Chesapeake Paper Products Company, For issuance of Certificates of Public Convenience and Necessity Pursuant to Va. Code § 56-265.2 and related regulatory approvals*, Case No. PUE950131, 1997 S.C.C. Ann. Rep. 349, 352 and 355, and Hearing Examiner Report at 29 (April 21, 1997).

¹⁷Id.

¹⁸*Application of Virginia Electric and Power Company, For a Certificate of Public Convenience and Necessity Pursuant to Va. Code §56-265.2 and Joint Application of Virginia Electric and Power Company, Richmond Power Enterprise, L.P. and Enron Power Marketing, Inc., For authority to enter into a purchased power contract without competitive bidding*, Case No. PUE960092, 1996 S.C.C. Ann. Rep. 313.

¹⁹The *Remington* case, supra at 428, 431.

required capacity to entities other than incumbent electric utilities if all things were equal.²⁰ Solicitation of market bids allows for comparison of those alternatives.

However, if the Company has recently solicited competitive bids, the Company may be found in compliance with the Bidding Rules, and consideration of a waiver becomes moot. Pending before the Commission is the Company's application to construct two combustion turbines at a site adjacent to the Company's Ladysmith Substation in Caroline County. As part of the support for that application, the Company submitted evidence of two competitive solicitations conducted in January of 1999 and December of 1999.²¹ In a January 1988 Order announcing policy guidelines for bidding programs, the Commission envisioned "a system in which a utility determining a need for additional power would issue, probably on an annual basis, a form of Request for Proposals, (RFP) identifying its requirements in broad general terms."²² Less than a year has passed since the Company's last solicitation for capacity from the market. Although a utility is certainly free to go to the market as often as it considers necessary, the Commission did not envision a system that **required** multiple solicitations in a relatively close time period. The Company has conducted a bid for generation that appears relevant to this case, and therefore, it may be able to justify the Possum Point Project in comparison to the alternatives recently bid. Consequently, I find that the recent solicitation may have satisfied the requirements set forth in the Bidding Rules, and the Commission need not direct the Company to solicit bids from the market even in a parallel track to the Commission's consideration of the Project as suggested by Staff. If the bids are relevant, the Company should offer that evidence in this case so that the Commission can consider whether a more cost-effective capacity alternative to the Project exists in the marketplace. If, however, the recent solicitation sought a different type of capacity, (i.e. only peaking) than the Project offers, and appropriate comparisons can not be made, the Company should be directed to conduct a solicitation on a parallel track as recommended by Staff. In comments to this Report, the Company should advise the Commission if the bids are relevant to consideration of market alternatives in this case.

The Standard of Review

The Commission must next consider the standard of review to apply in this case. The Company asserts that the standard for review of the pending application is set forth in Virginia Code § 56-580 D. In support of its position, the Company cites the General Assembly's decision to restructure Virginia's electric industry and to establish standards for approval of all new generation. The new standard established in § 56-580 D is intended to encourage the construction of generation in Virginia by reducing the requirements for approval of a project. That statute simply requires a finding that a proposed generating facility and associated facilities including transmission lines and equipment "(i) will have no material adverse effect upon reliability of electric service. . . (ii) are not otherwise contrary to the public interest." It also provides that:

[T]he Commission shall give consideration to the effect of the facility and associated facilities, ...on the environment and establish such conditions

²⁰*Id.* at 433.

²¹*Application of Virginia Electric and Power Company*, (the "*Ladysmith case*"), Case No. PUE000009, Hearing Examiner Report at 3 (August 7, 2000).

²²*Commonwealth of Virginia, ex rel. State Corporation Commission, Ex Parte: In the matter of adopting Commission policy regarding the purchase of electricity by public utilities from qualifying facilities when there is a surplus of power available*, Case No. PUE870080, 1988 S.C.C. Ann. Rep. 297, 298.

as may be desirable or necessary to minimize adverse environmental impact as provided in § 56-46.1.

The Company observes that utilities are not excluded from the application of the statute, and argues that the restructuring of the industry supplants the more burdensome requirements of §§ 56-265.2 and 56-234.3. The Company, however, also asserts that the Project meets the standards set forth in those statutes if the Commission considers them applicable.

Staff urges the Commission to consider the application pursuant to all applicable statutes including §§ 56-234.3 and 56-265.2, and again, I agree. Virginia Code §56-577 of the Virginia Electric Utility Restructuring Act (the “Act”) provides that the generation of electric energy shall not be subject to regulation under Title 56 except as specified in the Act after January 1, 2002.

The General Assembly did not repeal §§ 56-234.3 and 56-265.2, which it would have done had it intended § 56-580 D to apply exclusively to all new generation from the date of its enactment. The established rule of statutory construction provides that “when one statute speaks to a subject generally and another deals with an element of that subject specifically, the statutes will be harmonized, if possible, and if they conflict, the more specific statute prevails.”²³

The Commission’s regulation of the construction and operation of generating facilities must consider all applicable statutes, and until January 1, 2002, that consideration includes regulation under Title 56, and specifically §§ 56-234.3 and 56-265.2. There is no conflict between the review criteria set forth in the statutes, but rather, the statutes emphasize different aspects of the public interest criteria by which to judge the proposed construction, they complement each other and can be harmonized.

The provisions of § 56-234.3 are applicable when a jurisdictional utility, such as Virginia Power, proposes to construct new generation capable of producing 100 MW or more of electric energy. The new combined cycle facility that is proposed as part of the Possum Point Project is expected to generate 540 MW. This section requires the Commission to determine that the construction of a proposed project is “necessary to enable the public utility to furnish reasonably adequate service and facilities at reasonable and just rates.” It thus requires consideration of cost-effectiveness and system reliability. Virginia Code § 56-234.3 also requires that:

[P]rior to construction or financial commitments therefor, any electric utility subject to the jurisdiction of the State Corporation Commission intending to construct any new generation facility capable of producing 100 megawatts or more of electric energy shall submit to the State Corporation Commission a petition setting forth the nature of the proposed construction and the necessity therefor in relation to its projected forecast of programs of operation.”

Similarly, § 56-265.2 applies to any public utility proposing to construct facilities for use in public utility service. This section provides that “[i]t shall be unlawful for any public utility to construct. . .any facilities for use in public utility service. . .without first having obtained a

²³*Va. Dept. of Corrections v. Brown*, 259 Va. 697, 706 (2000) (citations omitted).

certificate from the Commission that the public convenience and necessity require the exercise of such right or privilege.” It requires a general assessment of the “public convenience and necessity” which includes economics, reliability, environmental concerns and more.

Section 56-46.1 also contributes to the required review criteria. It includes consideration of the effect of the facility on the environment and establish “such conditions as may be desirable or necessary to minimize adverse environmental impact” and, additionally, directs that the Commission “(i) may consider the effect of the proposed facility on economic development within the Commonwealth; and (ii) shall consider any improvements in service reliability that may result from the construction of such facility.”²⁴

The criteria for certification of a public utility generating facility proposed by a distribution public utility is clearly established, can be applied in harmony with the broader criteria in § 56-580 D of the Code of Virginia and has not yet been supplanted.

“At Risk” Financial Expenditures

If the Commission deems § 56-234.3 of the Code of Virginia to be applicable, the Company seeks approval to proceed with financial expenditures under that statute at its own risk. The Company notes that the protections afforded by the rate case settlement in Case Nos. PUE960036 and PUE960296²⁵ and its own restructuring efforts will ensure that customers will receive substantial benefits from the Project and will shield ratepayers from any base rate impact. Staff does not object to permitting the Company to begin expenditures at its own risk upon a showing of critical timing need, and further conditioned upon the bidding process uncovering no superior bid or bids for the supply of the needed capacity.

The Commission has granted interim authority similar to that requested in recent cases. In *Remington* a hearing was held and evidence was received on need before the Commission granted such interim authority.²⁶ In a second case notice and an opportunity for hearing was provided before interim authority was granted to the Doswell Limited Partnership.²⁷ Very recently the Commission granted authority to Virginia Power to do preliminary site work and make financial expenditures in the Ladysmith case. That authority was also granted after a hearing was conducted, evidence was received on need, and the Company asserted it would incur financial penalties if it could not begin preliminary work at its own risk.²⁸

Here, as in *Doswell*, notice and an opportunity to request a hearing was provided. Only Staff commented, and it does not object to granting Virginia Power authority to proceed at its own

²⁴Section 56-46.1 A.

²⁵*Virginia Electric and Power Company, 1995 Annual Informational Filing, Case No. PUE960036, Final Order; Commonwealth of Virginia, At the relation of the State Corporation Commission, Ex Parte: Investigation of Electric Utility Industry Restructuring – Virginia Electric and Power Company, Case No. PUE960296, 1998 S.C.C. Ann. Rep. 322.*

²⁶*The Remington case, supra.*

²⁷*Application of Doswell Limited Partnership (the “Doswell case”), Case No. PUE000092, Order Granting Exemption (April 20, 2000).*

²⁸*Applications of Virginia Electric and Power Company For approval of expenditures for new generation facilities and for a certificate of public convenience and necessity and for approval and certification of transmission facilities, Case No. PUE000009, Order Granting Interim Authority (July 28, 2000).*

risk. The prefiled testimony of Mr. Stadelmeier presents the same load forecasts recently examined in the Ladysmith case, and indicates a need for additional capacity in the current planning horizon.²⁹ That testimony creates a prima facie showing of capacity needs, although it will be subject to examination as this case proceeds.

I, however, have found no indication of why or when such preliminary site work and initial financial expenditures must begin. Since no objection was received I do not find it necessary to schedule a hearing to receive evidence on the necessity of the requested approval, but the Company should file an affidavit with the Commission as part of its comments to this report providing a schedule of when the expenditures must be made, the expected level of such expenditures, when preliminary site work must begin, and why the Company cannot wait until this case is finally decided. The Company should also be directed to file monthly reports of its expenditures. Moreover, it should be clear that any approval does not convey authority to operate the facility, and all financial undertakings are done solely at the Company's risk that the Commission will act favorably on the pending applications.

Upon consideration of the applicable statutes and rules, the applications and comments received thereon, I find that:

1. The Bidding Rules are applicable, but a waiver of those rules should not be granted and does not appear necessary in this case;
2. The Company should be directed to supplement its pre-filed direct testimony with information on the alternatives bid in its January 1999 and December 1999 solicitations if relevant to this case. If not relevant, the Company should so advise the Commission in comments hereto;
3. If the recent solicitation is not relevant to consideration of market alternatives herein, the Company should be directed to issue a Request for Proposals on a parallel track to consideration of this Project;
4. The application should be evaluated pursuant to Virginia Code §§ 56-46, 56-234.3, 56-265.2, and 56-580 D;
5. The Company should file an affidavit and schedule of expected expenditures as described above with its comments to this Report; and
6. Virginia Power should be granted interim authority to undertake permitting and preliminary site work, and to make financial expenditures for the proposed Project at its own expense and risk subject to the Commission's review of the supporting affidavit.

I therefore **RECOMMEND** that the Commission enter an order that:

1. **ADOPTS** the findings in this Interim Report;

²⁹Prefiled direct testimony of Charles A. Stadelmeier, at 3.

2. **GRANTS** the Company approval pursuant to § 56-234.3 to proceed with financial expenditures, permitting and preliminary site work as is necessary to facilitate the timely completion of the Possum Point Project, if finally approved by the Commission; and

3. **ESTABLISHES** a procedural schedule to receive evidence on the pending applications applying the statutory standards for review set forth in Virginia Code §§ 56-46, 56-234.3, 56-265.2 and 56-580 D.

COMMENTS

The parties are advised that any comments (Section 12.1-31 of the Code of Virginia and Commission Rule 5:16(e)) to this Report must be filed with the Clerk of the Commission in writing, in an original and fifteen (15) copies, within seven (7) days from the date hereof. The mailing address to which any such filing must be sent is Document Control Center, P.O. Box 2118, Richmond, Virginia 23218. Any party filing such comments shall attach a certificate to the foot of such document certifying that copies have been mailed or delivered to all counsel of record and any such party not represented by counsel.

Respectfully submitted,

Deborah V. Ellenberg
Chief Hearing Examiner